86-502

Supreme Court, U.S.
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No.

In The

Supreme Court of the United States

OCTOBER TERM, 1986

CUMBERLAND OIL CORPORATION AND SUGAR GROVE, LTD.,

Petitioners,

vs.

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., AND SOUTHERN TIER, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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(12937)

QUESTIONS PRESENTED

1. Whether summary judgment was appropriate where an issue of fact existed as to the injuries caused by Respondents' intentional misrepresentation.

2. Whether the Courts below could properly infer that no proof of damages could be made by Petitioners.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	*i*
TABLE OF AUTHORITIES	*iii*
PRELIMINARY STATEMENT	1
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOKED	2
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	4
CONCLUSION	6
APPENDIX A: Opinion of United States District Court for the Western District of New York	A-1
APPENDIX B: Opinion of the United States Court of Appeals for the Second Circuit	B-1
APPENDIX C: Order of the United States Circuit Court of Appeals for the Second Circuit	C-1
APPENDIX D: Petition for Re-argument	D-1

TABLE OF AUTHORITIES

CASES	Page
Burlington v. Underwood, 613 F.2d 91 (5th Cir. 1980) . . .	5
Jefferson Fourteenth Assoc. v. Wametco de Puerto Rico, Inc., 695 F.2d 524 (C.A. Fla. 1983)	5
Oregon R. R. & N. Co. v. Fairchild, 224 U.S. 510 (1911)	5
CONSTITUTIONAL PROVISIONS	
Fifth Amendment to the United States Constitution	4
STATUTES	
Rule 42(b) of the Federal Rules of Civil Procedure 28 U.S.C. 42	2
28 U.S.C. Section 1254(1)	2

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PRELIMINARY STATEMENT

Petitioners, Cumberland Oil Corporation and Sugargrove, Ltd., pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, rendered in the above-entitled proceeding on July 2, 1986.

OPINIONS BELOW

The opinion of the United States District Court (Telesca J.) printed in Appendix A hereto is not yet reported. The opinion of the United States Court of Appeals for the Second Circuit printed in Appendix B hereto is not yet reported. The Order of

the Court of Appeals denying Petitioners' Motion for Reargument is not yet reported, but is printed in Appendix C hereto.

JURISDICTION

Petitioners commenced this action against Respondents for intentional fraud. Respondents moved for summary judgment. The District Court granted Respondents' motion. The Court of Appeals affirmed this result, but for different reasons.

Petitioners' Motion for Reargument was denied.

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254 (1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOKED

The Fifth Amendment to the Constitution of the United States provides in pertinent part:

> "No person shall...be deprived of life, liberty, or property, without due process of law...."

Rule 42(b) of the Federal Rules of Civil Procedure pertains to separate trials and states as follows:

> The Court, in furtherance of convenience or to avoid prejudice, or when separate trials will be conducive to expedition and economy, may order a separate trial of any claim, cross-claim, counterclaim, or third-party claim, or of any separate issue or of any number of claims, cross-claims, counter claims, third-party claims, or issues, always preserving inviolate the right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a Statute of the United States.

STATEMENT OF THE CASE

This case arose out of three drilling contracts for gas wells between Petitioners and Benchmark Oil, Inc., (Benchmark), a now-bankrupt corporation of which Respondent Gregory Thropp was the president and sole shareholder.

Petitioners alleged that they entered into contracts in reliance upon Gregory Thropp's misrepresentation as to Benchmark's financial stability, while Gregory Thropp, under the direction of his father, Respondent James Thropp, who was *not* an officer, director or shareholder of Benchmark, was systematically looting the assets of Benchmark to form another corporation (Respondent Arrowhead Gas Producers, Inc.) which is a wholly-owned subsidiary of Respondent Southern Tier, Inc., (also formed by the Thropps).

Petitioners, Cumberland Oil Corporation and Sugargrove, Ltd., commenced this action on May 5, 1983, by filing the Summons and Complaint with the Clerk of the United States District Court, Western District of New York, alleging common-law fraud. Petitioners sought compensatory damages in the sum of Ten Million Dollars, special damages in the sum of Nine Million Dollars and punitive damages in the sum of Six Million Dollars.

Respondents brought a motion to strike the second amended Complaint. By Order entered on December 23, 1983, the District Court ruled that Petitioners had properly pleaded a common-law cause of action for fraud and conspiracy. Petitioners completed discovery prior to June 31, 1985.

After completing discovery, Petitioners brought a Motion for partial summary judgment addressed to Respondents' affirmative defenses and a Thirty Million Dollar Counterclaim interposed by Respondents. Respondents cross-moved for summary judgment. The District Court granted Respondents' Motion for summary judgment on August 29, 1985, and dismissed Petition-

ers' Complaint. The District Court, in granting Respondents' Motion, relied on *Mitchell Excavators, Inc. vs. Mitchell,* 734 F.2d 129 (2nd Cir. 1984)

The Court of Appeals, Second Circuit, held that *Mitchell* did not control. The Second Circuit affirmed the grant of summary judgment, however, reasoning that Petitioners failed to show any injury proximately caused by Respondents' misrepresentation. Petitioners' Motion for re-argument in the Court of Appeals was denied. Petitioners argued in the Motion for Reargument that the question of damages should not be determined until the question of liability was resolved, and relied specifically on Rule 42(b) of the Federal Rules of Civil Procedure in support of this contention. (A copy of the Petition for Re-argument is attached as Appendix D). No testimony as to the substantive law of the case has yet been taken. Petitioners now appeal from that decision.

REASONS FOR GRANTING THE WRIT

The Fifth Amendment to the United States Constitution provides that no person shall "be deprived of life, liberty or property without due process of law". The purpose of this clause is to exclude arbitrary power from every branch of the federal government.

Due process requires notice and an opportunity to be heard. The procedure must be free from the opportunity for arbitrary power. The grant of summary judgment by the Court of Appeals, *sua sponte,* violates this fundamental constitutional guarantee.

The District Court granted Respondents' motion for summary judgment on the theory that Petitioners should have filed their claim in bankruptcy. The Court of Appeals ruled that the District Court erroneously decided that the matter should be in bankruptcy. While the Court of Appeals agreed entirely with Petitioners' position concerning an action for fraud, the Court found that Petitioners had failed to establish that there was an issue of material fact on the question of injury resulting from Gregg

Thropp's misrepresentations and on that basis affirmed the judgment of the District Court granting summary judgment to Respondents.

Petitioners, in response to Respondents' motion for summary judgment, indicated to the District Court that they were attempting to separate the issue of liability and damages and specifically asked the Court of bifurcate the trial pursuant to Rule 42 (b) of the Federal Rules of Civil Procedure before taking any evidence on the damages issue. Proof of Petitioners' damages would have taken approximately two to two-and-one-half weeks. The District Court, by granting Respondents' Motion based on the *Mitchell* case, never reached the question of liability or damages and how proof was to be presented. The Court of Appeals did not address this problem. Accordingly, petitioners were denied the right to submit evidence on the issue of damages in violation of the Fifth Amendment's Due Process Clause. *See Jefferson Fourteenth Assoc. vs. Wometco de Puerto Rico, Inc.*, 695 F.2d 524 (C.A. 1983). (District Court's *sua sponte* order dismissing third-party claims deprived third-party plaintiff of its right to procedural due process). Judges do not enjoy unfettered discretion, but must justify their decisions in accordance with standards which constrain their discretion. 35 Univ. of Fla. L. Rev. (1983) 254, 221. Due process of law prohibits arbitrary and capricious acts. See *Oregon R. R. & N. Co. v. Fairchild,* 224 U.S. 510 (1911); *Burlington v. Underwood,* 613 F.2d 91 (5th Cir. 1980).

CONCLUSION

FOR ALL OF THESE REASONS, THE WRIT OF CERTIORARI SHOULD BE GRANTED.

Respectfully submitted,

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APPENDIX A

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

CUMBERLAND OIL CORPORATION, ET AL.,

Plaintiff(s)

vs.

JAMES THROPP, ET AL.,

CIV.83-0468T

Defendant(s)

Take notice of an order, of which the within is a copy, duly granted in the within entitled action on the 29th day of August 1985, and entered in the Office of the Clerk of the United States District Court, Western District of New York, on the 29th day of August 1985.

Dated: Rochester, New York
August 29, 1985

JOHN K. ADAMS, Clerk

U.S. District Court
Western District of New York
282 U.S. Courthouse
Rochester, New York 14614

TO: Robert L. Beck, Esq.
David Rothenberg, Esq.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

CUMBERLAND OIL CORPORATION and SUGARGROVE, LTD.,

Plaintiffs

v.

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., and SOUTHERN TIER, LTD.,

Defendants

CIV.83-0468T

DECISION and ORDER

INTRODUCTION

This case arises out of several drilling contracts for oil wells between plaintiffs and Benchmark Oil, Inc. ("Benchmark"), a now-bankrupt corporation of which defendant Gregory Thropp was President. Plaintiffs allege that they entered into the contracts in reliance upon Gregory Thropp's misrepresentations as to Benchmark's financial stability, while Gregory Thropp, under the direction of his father, defendant James Thropp, was systematically looting the assets of Benchmark to form another corporation, (defendant Arrowhead Gas Producers, Inc.), which is a wholly-owned subsidiary of defendant Southern Tier, Ltd. (also formed by the Thropps).

Pending before me is plaintiffs' motion to strike defendants' 15 affirmative defenses. Defendants concede that four of the affirmative defenses should be stricken, but oppose the plaintiffs' motion as to the 11 remaining affirmative defenses. Also pending is defendants' motion for summary judgment on two grounds, (1) that, even construing the facts in the light most favorable to plaintiffs, plaintiffs have not made out a claim for fraud or mis-

representation, and (2) that plaintiffs are barred from recovery because of their failure to file a proof of claim in the Benchmark bankruptcy. As set forth below, I grant defendants' motion for summary judgment on the second ground.

FACTS

The facts, in the light most favorable to plaintiffs, are as follows. In February of 1980, representatives of the plaintiffs attended a meeting at Benchmark's offices in Olean, New York. At that meeting, defendant Gregory Thropp made representations to the effect that Benchmark was financially sound, and would be able to perform its obligations under any oil drilling contracts. He refused to allow plaintiffs' representatives to review any of Benchmark's financial statements, claiming that Benchmark was a privately-held company. By date of March 22, 1980, plaintiff Cumberland Oil Corporation ("Cumberland") and Benchmark executed a drilling agreement for three gas wells, and an operating agreement for the wells once completed. The three wells had been drilled by August 11, 1980, and fractured by August 19, 1980. In addition, some work was done towards hooking up all three wells.

In the meantime, however, Benchmark was experiencing financial difficulties. Its accountant, Thomas C. Manning, testified at deposition that his 1979 financial statement for Benchmark, submitted in April or May of 1980, reflected a net loss in 1979 of $873,000. According to exhibits submitted by the plaintiffs, Benchmark had sold its Land Department to defendant Arrowhead (which the Thropps had incorporated on March 10, 1980) for $100,000 on March 21, 1980, the day before the Cumberland drilling and operating agreements were executed. On March 24, 1980 defendant James Thropp was repaid $18,000 of money he had loaned to Benchmark in 1979, which money was not due until January, 1981. He was repaid an additional $25,000 on April 23, 1980.

On May 27, 1980, Cumberland paid $126,875 to Benchmark for the drilling of the first well. On June 24, 1980 Cumberland paid Benchmark $126,875 for the drilling of the second well. On July 16, 1980 Cumberland paid Benchmark $142,480 for the completion of these two wells, and on July 17, 1980 Cumberland paid Benchmark $126,875 for the drilling of the third well. On August 26, 1980 Cumberland paid Benchmark $71,240 for the completion of the third well, making a total of $594,345, pursuant to the terms of the March 22nd drilling contract.

According to plaintiffs, defendants were busy misappropriating the assets of Benchmark during this time. Plaintiffs allege that Southern Tier was placing a value of $127,000 on lease acreage which its subsidiary Arrowhead had bought from Gregory Thropp for $100,000 plus 100 shares of Arrowhead, and which Gregory Thropp had in turn bought from Benchmark for a mere $7,266.50. Plaintiffs allege further that Benchmark transferred title to a Frank-Cabot drilling rig valued at $500,000 to RAMCO Drilling Inc. (which was 65% owned by Gregory Thropp). On September 18, 1980 Benchmark transferred to Gregory Thropp a completed well in Chautauqua County, New York. In September and October of 1980, Benchmark was proposing to sell off additional leasehold property and its Production Department to Arrowhead. On October 20, 1980, however, an involuntary petition in bankruptcy was filed against Benchmark.

On October 30, 1980 plaintiffs removed Benchmark as the operator of plaintiffs' three gas wells. Although plaintiffs (or at least plaintiffs' agents) were aware of the bankruptcy, plaintiffs never filed a proof of claim in Bankruptcy Court against Benchmark. All three of the wells eventually yielded some gas, although the bulk of the production came from one particular well.

During the course of the Benchmark bankruptcy, the Trustee in Bankruptcy, Mary Jane Nevins, O.S.F., brought a lawsuit on behalf of Benchmark's creditors against five defendants, the

four defendants in this case and Mr. Dennis Skeels, President of Arrowhead. In substance, the Trustee's lawsuit alleged that assets of Benchmark had been transferred to those five defendants without adequate consideration, to the detriment of Benchmark and its creditors. In the summer of 1982, those defendants offered to settle the Trustee's lawsuit by having Arrowhead purchase the assets of Benchmark for approximately 1.8 Million Dollars. After notice to all creditors who had filed proofs of claims, the Hon. Beryl E. McGuire, United States Bankruptcy Judge, approved the proposed settlement on November 12, 1982. The settlement provided for payment in full without interest of all timely-filed claims by Benchmark's creditors, along with all administration expenses. According to an affidavit submitted by the Trustee, all creditors who filed timely claims against Benchmark were paid in full, dollar for dollar, on or about May 3, 1983. On May 5, 1983 the complaint in this action was filed.

DISCUSSION

Defendants argue that plaintiffs' failure to file any proof of claim against Benchmark should preclude plaintiffs from seeking any relief against defendants. In response to plaintiffs' argument that it was Benchmark, not defendants, which went through the bankruptcy, defendants rely upon cases such as *Kelly v. Conwed Corp.*, 429 F. Supp. 969 (E.D.Va. 1977), and *Matter of Cross,* 666 F.2d 873 (5th Cir. 1982), for the proposition that the creditors of a corporation may not recover damages from a former corporate officer who is alleged to have misappropriated assets of the corporation.

In each of the cases cited by defendants, however, the former corporate officer himself was in bankruptcy, and the question presented to the Court was whether the officer's alleged debt to the corporation should have been discharged. In the present case, by contrast, it was only Benchmark itself, not its former officers (or the corporations they formed), which went through bank-

ruptcy, and the question presented is whether Benchmark's bankruptcy can be used by its officers as a shield from Benchmark's creditors. This question was squarely addressed by the Second Circuit in a case which the Court brought to the parties' attention shortly before oral argument, *Mitchell Excavators, Inc. v. Mitchell,* 734 F.2d 129 (1984).

In *Mitchell,* a shareholder brought a derivative action on behalf of a corporation in bankruptcy against officers, directors and key employees of the corporation who allegedly had mismanaged, diverted and wasted corporate funds in violation of their fiduciary duty. The Second Circuit upheld the District Court's dismissal of the action on the ground that, once the bankruptcy proceeding had commenced, the bankruptcy trustee succeeded to any right of action that the debtor corporation may have had to recover damages — either directly or by means of a derivative action — for the violation of fiduciary duty by officers or directors, under 11 U.S.C. Section 541. Although the Second Circuit noted that a shareholder could assert a cause of action of the debtor corporation under certain circumstances (such as the trustee's abandonment of the claim), the Court noted that "some proceeding in the Bankruptcy Court must take place before a shareholder can assert the right directly". 734 F.2d at 132.

Plaintiffs offered no convincing reason why the holding in the *Mitchell* case should not be applied in the present case. Plaintiffs argue that they are not shareholders of the corporation, unlike the plaintiff in *Mitchell,* and that the holding should be applied only in the context of shareholder derivative suits. Yet Benchmark's creditors in the bankruptcy proceeding were in essentially the same position as was the shareholder in *Mitchell* — both could enhance the value of their assets (whether claims against the bankrupt corporation, or shares in the bankrupt corporation) by asserting that the value had been diminished by the former officers' misappropriation of assets of the bankrupt corporation. *See Pepper v. Litton,* 308 U.S. 295, 307 (1939) ("that

standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation — creditors as well as stockholders" (footnote omitted)). The Trustee in the Benchmark bankruptcy asserted the claims of the creditors quite effectively, recovering the entire value of their claims, without interest. Accordingly, without prejudice to any subsequent attempt by plaintiffs to file a late proof of claim[1], I hold that, under the *Mitchell* case, this action must be dismissed because plaintiffs did not first present their claims to the Bankruptcy Court.

Plaintiffs argue that Judge Elfvin's holding in a similar action involving the defendants should collaterally estop the defendants from asserting that the Benchmark bankruptcy should bar plaintiffs here from asserting their claim. In that case, *Thropp v. Tee Pee Petroleums, Inc.*, Civ-83-1249E (W.D.N.Y.),[2] Judge Elfvin on May 8, 1985 refused to grant summary judgment to Arrowhead, Southern Tier, and James and Gregory Thropp on their arguments that Tee Pee Petroleums should have asserted its claims against them in the course of the Benchmark bankruptcy. Judge Elfvin refused to grant summary judgment, however, based upon the very confusing circumstances of that case. In particular, Judge Elfvin noted that Tee Pee had brought two adversary proceedings in Bankruptcy Court early in 1983, after Bankruptcy Judge McGuire's approval of the settlement but before the May 3, 1983 payout to creditors under the settlement. The adversary proceedings were resolved by a stipulation approved by a Bankruptcy Court order of April 4, 1983 under which the Thropps, Skeels, Southern Tier, and Arrowhead were to indemnify the Trustee from any litigation arising after March 24, 1983, and Arrowhead was to provide a $420,000 irrevocable letter of credit payable to the Trustee in the event that the Trustee was found liable under the actions brought by Tee Pee. As Judge Elfvin noted, however, "it is not clear from the record exactly what claims were settled and as to whom by the April 4, 1983 stipulation". Slip op. at 8.

I see no inconsistency between Judge Elfvin's decision in the Tee Pee case and my decision today, nor do I see any reason to give Judge Elfvin's decision collateral estoppel effect here. Although the facts of the Tee Pee case are undoubtedly confusing, it is at least clear that Tee Pee presented some or all of its claims in Bankruptcy Court before the termination of the Benchmark bankruptcy proceeding, and that its claims were addressed by the Bankruptcy Judge. Judge Elfvin refused to grant summary judgment against Tee Pee because it was unclear from the factual record in that case to what extent the Bankruptcy Court had already passed on Tee Pee's claims. By contrast, in the present case, it is clear that the plaintiffs' claims have never been presented to (let alone addressed by), the Bankruptcy Court. Accordingly, under the *Mitchell* case, they must be dismissed without prejudice.

Finally, plaintiffs argue that this Court's October 11, 1983 denial of defendants' pre-answer motion to dismiss on this ground amounted to a determination that this "bankruptcy defense" was without merit. A Rule 12(b)(6) motion is addressed only to the face of a complaint, and the district court's function on such a motion is not to weigh the evidence that might be presented at trial, but merely to determine whether the complaint itself is legally sufficient. *Goldman v. Belden,* 754 F.2d 1059, 1067 (2d Cir. 1985). Thus my denial of defendants' motion amounted to no more than a determination that plaintiffs' complaint on its face was sufficient.

CONCLUSION

The plaintiffs, who base their claims for relief upon a contract with a now-bankrupt corporation, may not assert a claim against the officers of that corporation arising out of the officers' misappropriation of corporate assets, without first presenting that claim to the Bankruptcy Court in the context of the corporation's bankruptcy. Accordingly, summary judgment is granted to defendants on the second ground alleged in their motion, and this action is dismissed without prejudice to plaintiffs' attempting to raise their claim in Bankruptcy Court.

ALL OF THE ABOVE IS SO ORDERED.

s/ MICHAEL A. TELESCA
United States District Judge

DATED: Rochester, New York
August 29, 1985.

FOOTNOTES:

1. My decision against the plaintiffs is in no way intended to prejudice the Bankruptcy Court concerning plaintiffs' filing of a proof of claim, or commencement of an adversary proceeding, against Benchmark at this late date. I note that the *Mitchell* decision was not handed down until after this action had been pending for a year, and I note further the confusion surrounding the Benchmark bankruptcy which Judge Elfvin described in his *Tee Pee* decision, *infra*. Yet it is the Bankruptcy Court, not this Court, which must determine in the first instance whether the case should be reopened under 11 U.S.C. Section 350 and whether plaintiffs should be allowed to assert their claims against Benchmark at this time.

2. By order dated June 14, 1984, I denied plaintiffs' motion to consolidate the *Tee Pee* case with the instant case, on the ground that the alleged material misrepresentations made by the Thropps were not the same in both cases.

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 709—August Term, 1985

(Argued January 22, 1986 Decided May 30, 1986)

Docket No. 85-7855

CUMBERLAND OIL CORPORATION and SUGARGROVE, LTD.,

Plaintiffs-Appellants,

—v.—

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., and SOUTHERN TIER, LTD.,

Defendants-Appellees.

Before:

MANSFIELD, MESKILL and PIERCE,
Circuit Judges.

Appeal from a judgment of the United States District Court for the Western District of New York, Telesca, *J.*, granting defendants' motion for summary judgment and

dismissing plaintiffs' fraud complaint against persons associated with a bankrupt corporation. The district court granted summary judgment under *Mitchell Excavators, Inc.* v. *Mitchell*, 734 F.2d 129 (2d Cir. 1984).

Affirmed on other grounds.

ROBERT L. BECK, Rochester, New York (Sutton, DeLeeuw, Clark & Darcy, Rochester, New York, of counsel), *for Appellants*.

DAVID ROTHENBERG, Rochester, New York (Geiger & Rothenberg, Rochester, New York, of counsel), *for Appellees*.

MESKILL, *Circuit Judge*:

This is an appeal from a judgment of the United States District Court for the Western District of New York, Telesca, *J.*, granting summary judgment and dismissing an action for fraud against persons associated with a bankrupt corporation. The district court granted summary judgment to the defendants under *Mitchell Excavators, Inc.* v. *Mitchell*, 734 F.2d 129 (2d Cir. 1984). Because of the district court's reliance on *Mitchell*, we assume that the court viewed the instant cause of action as property of the bankruptcy estate under 11 U.S.C. § 541 (1982).

We hold that the cause of action for fraudulent inducement of contract was not property of the bankruptcy estate under *Mitchell*. We affirm the grant of summary

judgment, however, because the plaintiffs-appellants failed to rebut the affidavits and depositions filed in support of the defendant-appellees' motion for summary judgment. The motion claimed the absence of injury flowing proximately from the alleged misrepresentations, an essential element of the fraud claim.

This disposition requires us to set out the facts in some detail. In doing so we rely, of course, on the complaint and on the affidavits and exhibits in support of the cross-motions for summary judgment.

BACKGROUND

1. *The Negotiations and the Contract*

Cumberland Oil Corporation (Cumberland) and Sugargrove, Ltd., a limited partnership, are both organized under Georgia law. In 1980 Cumberland was investigating the possibility of diversifying its operations by investing in gas wells. Gregory Thropp was the president and sole shareholder of a now-defunct corporation named Benchmark Oil (Benchmark). In early 1980 Benchmark was in the business of acquiring oil and gas properties, drilling oil and gas wells and operating gas wells. James Thropp, Gregory's father, was not an officer of Benchmark but apparently was "a big guy in the oil and gas business in the area" around Olean, New York. Thrasher Dep. at 30. James and Gregory Thropp are New York residents.

In February 1980 Cumberland's president, J. Robert Murray, Cumberland's lawyer, H. Grady Thrasher III, and several others met with Gregory Thropp in Benchmark's office in Olean, New York. The purpose of the meeting was for the Cumberland representatives to inves-

tigate Cumberland's entry into the gas business. Cumberland's consultant on the venture, Richard Beutel, had recommended Benchmark as a potential contractor to drill and operate the wells for Cumberland.

Attorney Thrasher accompanied Murray to the meeting with Gregory Thropp. Although Cumberland was "basically preconditioned to accepting" Benchmark as the driller of its wells, Thrasher Dep. at 14, Thrasher asked Thropp for recent financial information on Benchmark. The purpose of doing so was "to make sure that they didn't have creditors filing liens against them or that . . . they were[n't] on the edge of financial collapse because once you turn that money over to them, then it's up to them to deliver and perform under the contract." *Id.* at 15. According to Thrasher, Thropp replied that he would not disclose financial information and then "in an almost indignant way, he said basically rest assured that we are very capable of doing the job, and we are in . . . excellent financial shape, and we have been in the Olean area for years and, you know, have always lived up to our financial commitments." *Id.*[1]

On March 22, 1980 Benchmark and Cumberland executed a "Drilling and Development Agreement" in which Benchmark agreed to drill up to three wells. Cumberland agreed to pay a "turnkey price" for each well and Benchmark was to drill the well "to such depth as is, in the opinion of the qualified geologist or petroleum engineer employed by Cumberland, adequate to properly test the . . . formation," Complaint, Ex. A, ¶ 3(a). The

[1] Gregory Thropp also presented and discussed some production records for wells that Benchmark had recently drilled. These records showed very significant production. Murray Dep. at 94-95. He made no assurances that the wells Benchmark might drill for Cumberland would produce at the same levels. *Id.* at 97.

contract provided for each well to be tested before Benchmark was paid for the well and before it undertook to drill the succeeding well. *Id.* at ¶ 3(a)-(c).[2]

Cumberland had a side agreement with its engineering consultant's firm that specifically referred to the three wells and provided that when Cumberland requested, the firm would furnish "supervision of field operations concerned with the drilling and operation of the wells, engineering supervision during well completion, engineering studies" and other services, J. App. at 36.

Benchmark drilled the three wells and Cumberland paid for them. When problems developed in drilling one of the wells, Benchmark redrilled it. Yet, despite these efforts, only the last of the three wells ultimately produced gas in commercially salable quantities; this well produced ninety percent of the gas produced by the three wells.

The parties do not dispute that water intruding into two of the wells reduced the amount of gas that could come up through the wells. Cumberland claims that the intrusion of water was caused by "fracturing" the wells at the wrong depth and by leaving acid in the well holes too long.[3]

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2 The contract also provided that Benchmark would hook up the wells to a pipeline. The parties made a separate agreement that Benchmark would operate the wells for Cumberland in return for a fee.

3 The fracturing of a gas well occurs during the "completion process" by which a well whose drilling has been completed is prepared for production. A sister court has described the "fracturing" process as "involv[ing] pumping water or another liquid mixed with sand into the well at [high pressure]. The pressure forces open fractures in the reservoir rocks thereby permitting a greater amount of oil or gas to reach the well." *Western Company of North America* v. *United States*, 699 F.2d 264, 266 n.3 (5th Cir.), *cert. denied*, 464 U.S. 892 (1983). Acid is used in the completion process. "Acidizing" has been described as a

Between March and October 1980 Benchmark drilled nineteen wells in addition to the three wells drilled for Cumberland.

2. *The Bankruptcy and the* Monroe Resource *Case*

Gregory Thropp's representation that Benchmark was in good financial shape was either incorrect in February 1980 or was soon to become so. Circumstances changed substantially before Benchmark and Cumberland signed their contract in March 1980. In late February Benchmark assigned some of its royalty rights to the Thropps. The record is silent as to what Benchmark received in return. On March 21, 1980 Benchmark sold its land department for $100,000 to a corporation owned by the Thropps. On March 24, 1980 Benchmark assigned 2,542 acres of land to Gregory Thropp for $7,266.50, Benchmark's purchase price. These transactions stripped Benchmark of valuable assets.

During the spring and summer of 1980 the Thropps carried out a series of transactions involving the establishment of new corporations and the transfer of assets in and out of those corporations. It is unclear from the record to what extent these transactions involved the misappropriation or fraudulent conveyance of Benchmark assets. It does not appear that Gregory Thropp ever admitted liability for misappropriation or fraudulent con-

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process in which "a solution of . . . acid is pumped into a well which has been completed . . . . The acid dissolves part of the rock, thereby increasing its permeability and stimulating a greater flow of oil or gas into the well." *Western Company*, 699 F.2d at 266 n.2. When the acid is left in the well too long, it damages the pipe that is in the hole. The acid was left in the three Cumberland wells for thirteen days, nine days and fourteen days, respectively. Coincidentally, the well in which acid was left the longest was the largest producer.

veyance of Benchmark assets. These transactions are relevant here only to the extent that they support Cumberland's charge that the Thropps had a "plan" and a conspiracy to defraud Cumberland by inducing it to enter into a contract with a business that had effectively ceased to exist.

On October 20, 1980, after the three Cumberland wells were drilled, one of Benchmark's creditors served it with a petition of involuntary bankruptcy. Cumberland learned of this development and removed Benchmark as the operator of the three wells.

A Benchmark creditor, Monroe Resources, Inc., sued the Thropps in New York state court in pleadings dated October 9, 1981. The *Monroe Resources* complaint pled causes of action for misrepresentation, breach of contract and negligence. That action was settled and, to avoid the consequences of a preferential transfer, the settlement was conditioned upon Benchmark's paying in full all creditors whose claims had been filed with the bankruptcy court. Cumberland was not among these creditors.

Although Cumberland had notice of Benchmark's bankruptcy, it did not file a claim in bankruptcy court for breach of contract or negligence against Benchmark, presumably because the limitations period for filing claims under Bankruptcy Rule 3002 had expired. *See* Bankr. R. 3002(c); Br. of Plaintiffs-Appellants at 4; J. App. at 294, 302. *See also In re Sullivan*, 36 B.R. 771, 772 (Bkrtcy. E.D.N.Y. 1984).[4]

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[4] Cumberland could have filed a claim in the bankruptcy court whether that claim was "reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured" or if it were a "right to an equitable remedy for breach of performance if such breach [gave] rise

The settlement in the *Monroe Resources* case was specifically approved by the bankruptcy court on November 17, 1982. Benchmark's bankruptcy trustee had also filed an action in the bankruptcy court against the Thropps and their corporations for fraudulent transfers. She received authority to compromise that case and the action was later dismissed.

3. *Proceedings Below*

Cumberland consulted with Monroe Resources' attorney as early as January 1982 about pursuing a common law remedy for fraud against the Thropps. Cumberland and the attorney agreed that he would "try to help" Cumberland as soon as the settlement check in the *Monroe Resources* case cleared. J. App. at 312.

On May 5, 1983, two days after Benchmark's creditors were paid dollar for dollar on their timely claims, Cumberland filed a complaint against James Thropp, Gregory Thropp and their corporations alleging causes of action for fraud, breach of contract and negligence. The Thropps moved to dismiss the complaint. The district court held that Cumberland stated a cause of action for fraud against Gregory Thropp but dismissed the contract and negligence claims as to all defendants. It dismissed the fraud claim against James Thropp and the Thropps' corporations without prejudice and with leave to replead. We affirmed the dismissal of the contract and negligence claims. *Cumberland Oil Corp.* v. *Thropp*, 732 F.2d 141 (2d Cir. 1984) (unpublished order).

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to a right to payment, whether or not such right to an equitable remedy [was] reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured." 11 U.S.C. § 101(4).

Cumberland's Second Amended Complaint stated claims for fraud against James Thropp and Gregory Thropp as principals in a "conspiracy to defraud the plaintiffs." J. App. at 69 ¶ 16. The complaint stated that Benchmark was obligated "to provide the proper men, equipment and materials to perform the [Cumberland] contract in a good and workmanlike manner." *Id.* at 42 ¶ 24. The complaint went on to allege that due to the "stripping of Benchmark assets in March of 1980, Benchmark [became] a shell corporation without the mechanical or technical capacity or financial ability to fulfill the terms of the contract." *Id.* at 72 ¶ 25.

After the denial of a motion to dismiss the amended complaint and a year and a half of discovery proceedings, Cumberland and Sugargrove submitted a motion, supported by affidavits and exhibits, for partial summary judgment dismissing the defendants' counterclaim and affirmative defenses. The Thropps filed a similarly supported cross-motion for summary judgment. Their motion papers asserted that Gregory Thropp's statements about Benchmark's financial health were statements of opinion, not misrepresentations of fact. The Thropps' motion papers also asserted that Benchmark (1) did drill the three wells, (2) drilled nineteen other wells between March and October 1980, (3) used essentially the same crew to drill Cumberland's wells that it used on the other wells, and (4) redrilled one of the Cumberland wells at no charge to Cumberland. These four affirmations, which went to the question of whether Cumberland had suffered a fraud "injury," were not disputed.

Cumberland instead responded by submitting a detailed "Chronology of Events" arguing that a misrepresentation of fact indeed occurred. The "Chronology" attempted to

demonstrate that Gregory Thropp misrepresented Benchmark's financial health to Cumberland and that the Thropps embarked upon a scheme to loot Benchmark before Benchmark and Cumberland entered into their contract.

Responding to the Thropps' arguments on the issue of injury, Cumberland made only this statement:

> 10. That, finally, plaintiffs note the frequent references to technical matters concerning the so-called adequacy of the drilling of the wells at issue, and ask the Court to realize that plaintiffs have attempted to distinguish in the preparation of this cause between liability and damages; *that they have, to date, offered no proof concerning the damage which, by virtual abandonment, was caused to these wells*. That plaintiff submits that expert testimony concerning the foregoing should be left until the time of trial and after a determination of liability is made by the Court.

J. App. at 257 (additional emphasis added). Cumberland thus declined to respond to the argument that Cumberland got all that it contracted for and did not suffer any injury, regardless of Gregory Thropp's representations regarding Benchmark's financial health.

Prior to oral argument on the summary judgment motions, the district court called the parties' attention to *Mitchell Excavators, Inc.* v. *Mitchell*, 734 F.2d 129 (2d Cir. 1984). In *Mitchell* we held that a shareholder's derivative action was property of the bankruptcy estate and directly prosecutable by the trustee in bankruptcy. *Id.* at 130. The district court relied on *Mitchell* and dismissed the instant action without prejudice to the plaintiffs'

attempting to assert their claim in the bankruptcy court. The court reasoned that "Benchmark's creditors in the bankruptcy proceeding were in essentially the same position as was the shareholder in *Mitchell*—both could enhance the value of their assets . . . by asserting that the value had been diminished by the former officers' misappropriation of assets of the bankrupt corporation." J. App. at 274-75.

On this appeal Cumberland argues that *Mitchell* does not apply to this case because this is an action for fraud. Cumberland claims that it is entitled to a trial on the fraud claim against James Thropp and Gregory Thropp.

DISCUSSION

1. *The Bankruptcy Estate*

Under section 541 of the Bankruptcy Code the bankruptcy estate includes, with exceptions not relevant here, "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Section 541 has been construed to prevent individual shareholders and creditors from suing to enforce a right of the corporation when that corporation is in bankruptcy. *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1275 (5th Cir. 1983) (holding that action by creditor under the Texas Fraudulent Transfers Act belongs to the bankruptcy estate); *Mitchell*, 734 F.2d at 131 (shareholder's derivative suit is property of the estate); *see also Pepper* v. *Litton*, 308 U.S. 295, 306-07 (1939) (construing § 70(a) of the Bankruptcy Act of 1898, 11 U.S.C. § 110(a) (repealed 1978), and noting that trustee can bring both direct and derivative actions for breach of fiduciary duty).

Making the pursuit of certain causes of action the sole responsibility of the trustee in bankruptcy furthers the fundamental bankruptcy policy of equitable distribution among creditors. *See MortgageAmerica*, 714 F.2d at 1275. It allows the trustee to exercise the "strong arm" power and recover corporate assets for the benefit of all creditors of the corporation. *See id.* This policy would only be relevant to this case, however, if Cumberland had asserted rights belonging to the corporation by suing under the New York fraudulent conveyance statute. *See* 11 U.S.C. § 544(b); N.Y. Debt. & Cred. Law § 270-81 (McKinney 1945); *see also In re O.P.M. Leasing Services*, 28 B.R. 740, 759 (Bkrtcy. S.D.N.Y. 1983) (right to sue directors and officers of bankrupt corporations for breach of their fiduciary duties and for violating fraudulent conveyances law passes to bankruptcy trustee).

Benchmark's right to recover misappropriated corporate assets was vindicated by the bankruptcy trustee's suit against the Thropps. In the case before us, however, Cumberland has not claimed a right on its own or Benchmark's behalf to recover misappropriated assets. Instead, it alleges that it suffered damages because of Gregory Thropp's intentional fraud. The right to recover for this alleged tort belongs to Cumberland, not to Benchmark. The cause of action is Cumberland's property, not part of the bankruptcy estate. Thus, this case is not controlled by *Mitchell*. *See Teledyne Industries* v. *Eon Corp.*, 401 F.Supp. 729, 735-36 (S.D.N.Y. 1975) (actions for fraud and conversion brought against individual officers of bankrupt corporation not barred by confirmation of arrangement including plaintiff's claim against corporation itself in the bankruptcy proceeding), *aff'd sub nom. Teledyne Industries* v. *Podell*, 546 F.2d 495 (2d Cir.

1976) (per curiam, affirming on opinion of district court); *cf.* 4 Collier on Bankruptcy ¶ 541.10[8] at 541-67 to 541-68 (L. King ed. 1985) (where state law confers on creditors a *personal* right to levy an assessment on unpaid shares of stock held by corporate officers or directors, rather than conferring such a right on the corporation, trustee does not have standing to collect the assessment).

The Thropps also argue that Cumberland's claims are merely artful repleadings of claims that would either be property of the bankruptcy estate or discharged in bankruptcy. It is true that the same facts that Cumberland pled in its complaint could have been pled in support of claims of breach of contract or violation of the fraudulent conveyance laws, all of which would either be property of the estate or would be discharged. *See* 11 U.S.C. § 727(b) (discharge of all unexcepted debts arising before date of discharge); 11 U.S.C. § 101(4), (11) (definitions of "claim" and "debt"); *MortgageAmerica*, 714 F.2d at 1275-76 (creditors' action under state fraudulent conveyances act becomes property of estate); *Mitchell*, 734 F.2d at 131 (stockholder's derivative right of action passes to estate). Indeed, Cumberland appears to concede that it grounded its complaint on a fraud theory only because it missed the statute of limitations for filing a claim as a creditor.

It is also true that a fraud complaint may be dismissed where it merely restates contract claims. *Freyne* v. *Xerox Corp.*, 470 N.Y.S.2d 187, 188 (App. Div. 4th Dep't 1983). Nevertheless, we conclude that the complaint was not merely an artful repleading of claims that were discharged in bankruptcy because Cumberland has alleged with particularity that misrepresentations of facts were made by

Gregory Thropp in furtherance of a conspiracy to defraud Cumberland.

Thus, the district court erred when it granted summary judgment to the Thropps on the basis that Cumberland's action for fraud was property of the estate under *Mitchell* or was discharged in bankruptcy.

2. *Summary Judgment*

Although we have concluded that the district court incorrectly applied *Mitchell* in granting summary judgment to the Thropps, we nevertheless determine that it is appropriate to affirm the grant of summary judgment. *Reynolds* v. *United States*, 643 F.2d 707, 710 (10th Cir.), *cert. denied*, 454 U.S. 817 (1981); *Church of Scientology of California* v. *Cazares*, 638 F.2d 1272, 1281 (5th Cir. 1981). "The appellate court does not have to affirm a decision on a Rule 56 motion for the same reasons that persuaded the court below to grant the motion." 10 C. Wright, A. Miller, M. Kane, Federal Practice and Procedure, § 2716 at 658 (1983); *see also Helvering* v. *Gowran*, 302 U.S. 238, 245 (1937) ("In the review of judicial proceedings the rule is settled that if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason."); *Walton* v. *Morgan Stanley & Co.*, 623 F.2d 796, 797 & n.1 (2d Cir. 1980) (citing *Helvering* v. *Gowran*, 302 U.S. at 245-46).

We would hesitate to affirm the grant of summary judgment if the proper ground for granting it had not been raised and argued below. *See British Airways Board* v. *Port Authority*, 558 F.2d 75, 82 (2d Cir. 1977). However, the ground we hold to be proper for granting

summary judgment was raised and argued below. Therefore, we may rely on it in affirming the result reached below.

The purpose of summary judgment is "to pierce the pleadings and to assess the proof in order to see whether there is a genuine need for a trial." Fed. R. Civ. P. 56 advisory committee note (1963 Amendment). Thus, Rule 56(e) requires that when one party moves for summary judgment and supports the motion with affidavits and exhibits "an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth *specific facts* showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e) (emphasis added).

This requirement is especially critical where, as here, a defendant has moved for summary judgment and has presented evidentiary materials that negate one or more elements of the plaintiff's *prima facie* case. Where the defendant demonstrates that there is no evidence to support an essential element of the plaintiff's claim, then "trial would be a bootless exercise, fated for an inevitable result but at continued expense for the parties, the preemption of a trial date that might have been used for other litigants waiting impatiently in the judicial queue, and a burden on the court and the taxpayers." *Fontenot* v. *Upjohn Co.*, 780 F.2d 1190, 1195 (5th Cir. 1986).

Under New York law a person who induces another to enter into a contract by misrepresenting a material fact or making a promise that he or she has no intention of keeping may be held liable in damages for fraud. *DiRose* v. *PK Management Corp.*, 691 F.2d 628, 630 (2d Cir. 1982), *cert. denied*, 461 U.S. 915 (1983); *Channel Master*

Corp. v. *Aluminum Limited Sales, Inc.*, 176 N.Y.S.2d 259, 262-63 (Ct. App. 1958). The essential elements of the cause of action are

> (1) that the defendant made a representation, (2) as to a material fact, (3) which was false, (4) and known to be false by the defendant, (5) that the representation was made for the purpose of inducing the other party to rely upon it, (6) that the other party rightfully did so rely, (7) in ignorance of its falsity (8) to his injury.[5]

Brown v. *Lockwood*, 432 N.Y.S.2d 186, 193 (App. Div. 2d Dep't 1980); *see also Computerized Radiological Services* v. *Syntex Corp.*, 786 F.2d 72, 76 (2d Cir. 1986). The misrepresentation of a material fact must have proximately caused the injury. *Cable* v. *Hechler*, 532 F.Supp. 239, 245 (E.D.N.Y. 1981), *aff'd mem.*, 685 F.2d 423 (2d Cir. 1982); *see Rumph* v. *Gotham Ford, Inc.*, 355 N.Y.S.2d 114, 117 (App. Div. 1st Dep't), *appeal dismissed*, 359 N.Y.S.2d 566 (Ct. App. 1974); *Central State Bank* v. *American Appraisal Co.*, 307 N.Y.S.2d 708, 709 (App. Div. 1st Dep't 1970), *aff'd*, 319 N.Y.S.2d 615 (Ct. App. 1971); *Latzko* v. *Spector*, 284 N.Y.S.2d 545, 546 (App. Div. 1st Dep't 1967), *aff'd*, 291 N.Y.S.2d 818 (Ct. App. 1968). An injury is proximately caused if it is the natural and probable consequence of the defrauder's misrepresentation or if the defrauder ought reasonably to have foreseen that the injury was a probable consequence of his fraud. *Cable*, 532 F.Supp. at 245; *see also Montague Associates* v. *Gallo Wine Distributors*, 172 N.Y.S.2d 203, 205 (Sup. Ct. 1958). In this case the Thropps have

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[5] For the purposes of this decision we are assuming without deciding that Gregory Thropp's statements about Benchmark's financial condition were statements of fact.

demonstrated that there is no genuine issue of fact regarding whether Cumberland suffered injury as a proximate result of Gregory Thropp's alleged misrepresentation. Thus, it would be a "bootless exercise" to remand this case for trial.

Cumberland's theory was that, as of February 16, 1980, Gregory Thropp knew that Benchmark would be so weakened by looting that it would virtually have to abandon the drilling of Cumberland's wells. The Thropps' moving papers attacked this theory of Cumberland's injury stating, "plaintiffs allege that Gregory Thropp defrauded them when he stated that Benchmark was ready, willing and able to carry out its contractual obligations with Cumberland. However, the record is very clear that Benchmark did just that." J. App. at 170 ¶ 22.

The motion papers contained documentary and deposition evidence to establish that (1) Benchmark drilled three wells for Cumberland, including the redrilling of one well, (2) Benchmark drilled nineteen other wells between March and October 1980, and (3) Benchmark kept its usual field crew on the job when it drilled Cumberland's wells.

Cumberland's response to this detailed showing was to fall back on the allegations in its complaint. Its counsel acknowledged that it had "offered no proof concerning the damage which, by virtual *abandonment*, was caused to these wells." J. App. at 257 ¶ 10.[6]

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6 The "Chronology" that Cumberland's counsel submitted in opposition to the summary judgment motion attempted to develop this "abandonment" theory by stating that Gregory Thropp divorced himself from the day-to-day operations of Benchmark and stopped soliciting business for Benchmark. Yet Cumberland offered no elaboration of what facts it relied on to prove that the *wells* were abandoned

Cumberland, belatedly recognizing this void in its response to the motion for summary judgment, states in its reply brief on this appeal that "[n]o expert testimony has *yet* been taken on the question of *actual damages*, damages proximately caused by Benchmark's financial inability to properly drill the wells at issue and to take the expensive steps technically to avoid the irreversible damage that was caused." Reply Br. of Plaintiffs-Appellants at 5-6. Cumberland also makes vague promises to prove at trial that contract payments were not properly applied and that "work on these wells was virtually abandoned by Gregory Thropp." *Id.* at 6.

There is no need, however, to inflict the expense and burden of further proceedings on the Thropps. Discovery in this case lasted for over a year and a half. Cumberland does not argue that the Thropps prevented it from supporting its allegation that Benchmark injured it by abandoning the Cumberland wells. Furthermore, Cumberland makes no effort to justify its failure to inform the district court of the reasons why it failed to provide affidavits to support this essential element of its case. *See* Fed. R. Civ. P. 56(f).

Most importantly, the proof that Cumberland offers to provide after further discovery would not establish a genuine issue of fact as to whether Cumberland suffered a fraud injury. As a matter of law, none of the "injuries" that Cumberland suggests it could prove after further discovery would establish a fraud injury.

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by Benchmark. It is irrelevant to this case what Gregory Thropp did or failed to do during the spring and summer of 1980. The drilling contract was not a personal services contract and did not require Gregory Thropp to make daily visits to the drilling sites.

Further proof of Benchmark's financial troubles, for instance, would not prove a fraud injury to Cumberland. The drilling contract did not specify that Benchmark was to undertake any particular "expensive steps" as alleged by Cumberland. Rather, it provided that Benchmark was to drill wells to meet the standards of Cumberland's geologist, to complete the wells if the geologist approved and then to turn the completed wells over to Cumberland. The contract further provided that Benchmark would not be paid until Cumberland's consultant was satisfied that Benchmark had performed by drilling each well to his specifications. Cumberland paid Benchmark. Moreover, Benchmark kept full crews on the Cumberland wells and when the need arose Benchmark was able to take the "expensive step" of redrilling a well. In short, Cumberland has failed to produce *any* evidence of a link between Benchmark's financial condition and alleged deficiencies in Benchmark's performance of the contract. Additional proof of Benchmark's financial straits will not forge that link.

In addition, what Benchmark did with the payments for the wells is irrelevant. Under the drilling contract Benchmark did not become entitled to receive payment for a well until Cumberland's consultant approved that well. Even if the Thropps did in fact misappropriate the payments, that fact is irrelevant as long as the next well was drilled in a workmanlike fashion and met geologist's specifications. *See* 4 W. Summers, The Law of Oil and Gas, § 684 at 167 (1962). What Cumberland bargained for in its contract with Benchmark was the drilling of gas wells, not for an equity interest in or a chattel security interest against Benchmark. Cumberland, therefore,

could not prove a fraud "injury" by providing further proof of corporate looting.

CONCLUSION

The district court erred when it concluded that Cumberland's fraud action was property included in the bankruptcy estate. Cumberland failed to establish, however, that there is a genuine issue of a material fact on the question of injury resulting from Gregory Thropp's alleged misrepresentations. The Thropps are thus entitled to summary judgment as a matter of law and, accordingly, the judgment of the district court is affirmed.

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APPENDIX C

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UNITED STATES COURT OF APPEALS, SECOND CIRCUIT, FILED JUL 02 1986, ELAINE B. GOLDSMITH, CLERK

In The

United States Court of Appeals

for the
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the second day of July one thousand nine hundred and eighty-six.

Present: HON: WALTER R. MANSFIELD
HON: Thomas J. MESKILL
HON: LAWRENCE W. PIERCE

Circuit Judges,

CUMBERLAND OIL CORPORATION and SUGAR GROVE, LTD.,
Plaintiffs-Appellants,

V.

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., and SOUTHERN TIER, LTD.,
Defendants-Appellees.

Docket No. 85-7855

A petition for a rehearing having been filed herein by

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

s/ Elaine B. Goldsmith
Clerk

APPENDIX D

85-7855

In The

United States Court of Appeals

For the Second Circuit

CUMBERLAND OIL CORPORATION AND SUGARGROVE, LTD.,

Plaintiffs-Appellants,

vs.

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., AND SOUTHERN TIER, INC.,

Defendants-Appellees.

On Appeal From the United States District Court For the Western District of New York

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PETITION FOR REARGUMENT BY PLAINTIFFS-APPELLANTS CUMBERLAND OIL CORPORATION AND SUGARGROVE, INC.

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United States Court of Appeals

For the Second Circuit

CUMBERLAND OIL CORPORATION AND SUGAR-GROVE, LTD.,

Plaintiffs-Appellants,

vs.

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., AND SOUTHERN TIER, INC.,

Defendants-Appellees.

PETITION FOR REARGUMENT

(Pursuant to F.R.A.P. 40)

The plaintiffs-appellants above named respectfully petition this Honorable Court for a rehearing of the appeal in the above-entitled cause, and in support of this petition represent to the court as follows:

We reserve our argued position as to each of the points of appeal, but in this petition address ourselves solely to that feature of the decision wherein we believe the court may be convinced its result is based upon the application of incorrect legal principles or facts.

Therefore, this petition is devoted to convincing this Court that it has erred in its determination that;

"As a matter of law, none of the 'injuries' that Cumberland suggests it could prove after further discovery would establish a fraud injury" (page 3734 of the printed opinion of the Court).

And:

"In short, Cumberland has failed to produce *any* evidence of a link between Benchmark's financial condition and alleged deficiencies in Benchmark's performance of the contract" (page 3735 of the printed opinion of the Court).

Plaintiffs-appellants make no representation that they have yet offered the proof above referred to. This Court has simply *inferred* that no such proof exists.

Moreover, the Court's attention is called to the plaintiffs-appellants' reply affidavit to Defendant's Opposition (A-254) wherein the following is stated: "10. That, finally, plaintiffs note the frequent references to technical matters concerning the so-called adequacy of the drilling of the wells at issue, and ask the Court to realize that plaintiffs have attempted to distinguish in the preparation of this cause between liability and damages; that they have, to date, offered no proof concerning the damage which, by virtual *abandonment* was caused to these wells. The plaintiff submits that expert testimony concerning the foregoing should be left until the time of trial and after a determination of liability is made by the Court.

"11. That this affidavit is made within the spirit and intent of *Rule 16, Title 28, USC* and, in short, your deponent asks this Court to exercise the discretion therein described."

Since the Trial Court opted to summarily dismiss the plaintiff's claim on grounds which this Court has now completely reversed the above request was never addressed and *remains* unaddressed.

It is submitted that if the Trial Court *had* addressed that request, it was empowered to do one of two things:

First, it could have taken the position that a matter of this complexity should be bifurcated and we will consider the questions of jurisdiction and liability first *since the question of damages might become moot. F.R. Civ. P. 42 (b).* See also: *Moss v. Associated Transport, Inc., (1965), 344 F² 627.*

Or secondly, the Trial Court could have said, No, we will take your offer of proof now despite the obvious time and expense that would be necessarily involved.

Plaintiffs-appellants took the above stated approach because of the oft-stated policy of the Trial Court to urge trial counsel to take whatever steps possible to narrow litigation issues and preserve and protect the Court's time.

Plaintiff-appellants did not *ignore* the question of proving damages. They simply asked the Court to be permitted to offer their proof in an orderly and *comprehensible* manner. Again, with summary judgment granted to the defendants-appellees their request was simply never responded to.

The request was made because plaintiffs-appellants had planned to scrutinize for the Court the construction of each of these three, mile-deep wells step by step with expert testimony to show the omission of many necessary processes which would have entailed the outlay of the funds the plaintiff-appellants had paid which omissions caused the damage or destruction that followed.

The presentation of such testimony would have consumed, in plaintiff-appellants' opinion, from two to two-and-a-half weeks.

Had the appellant been given the opportunity to present proof as to damages, they would have brought to the stand the following individuals:

John Nalbone, vice president of J & L Oil and Gas Corporation, Dunkirk, New York, whose company performed the completion work at the cost of approximately $40,000 to attempt to save the three wells.

Donald Godson, retired engineer for the Dowell Division of the Dow Chemical Company, now employed as a consultant by J & L who is a specialist in the "perfing" and "fracting" of gas wells and who also studied the appellants' problems — problems created by the defendant's neglect to take the appropriate steps — and spend the appropriate money — to prevent the irreversible damage that was done to Appellant's property.

Louis Nalbone, president of J & L who did the actual attempted completion work on said wells and discovered the mistakes made.

John Vleminckx, now with Envirogas, Inc. and formerly in charge of well-fracting for the Halliburton Company and who supervised the actual fracting of the wells at issue and who would testify to the fact that through the failure to timely hire Halliburton, who was then on a COD basis with Benchmark, acid was left at the bottom of the wells far beyond the recommended time of 5 to 6 days (in one instance 45 days) and to the damage or destruction of all three wells.

Attached hereto and marked Exhibit A is an affidavit prepared by the above named Louis Nalbone describing one of the things that could have been done to prevent the damage which occurred. The item of contractor's cost savings in the sum of $3,000 described by affiant Nalbone is only an example, and is not the ex-

tent of the failure in contract performance. Time constraints prohibited securing affidavits from other experts named above.

The above is offered by way of illustrating the kind of proof that would have been proffered the Court to establish the "link" between Benchmark's financial condition and the actual, extensive damage to appellants' property.

Plaintiffs-appellants believe the above and, additional more detailed testimony and proof, will establish that Gregory Thropp took the Appellants' money, did a mere modicum of work on the wells, re-drilled the first of the wells *because according to the terms of the contract he could not collect the remaining two thirds of the price without doing so,* never visited the job site or supervised the drilling and — in short did not apply the appellants' money in the *manner and amount* he should have to bring in working wells and he did the above knowing when he signed the contract that he *would not* and *could not* perform as required.

All of the above would be in addition to the testimony of Dennis Skeels and other Benchmark employees already taken establishing the fact that Gregory Thropp was never on the job site. This was because he had taken the Appellants' money and applied it to other interests.

It seems that since everything to date has involved pre-trial proceedings, that to deprive the Appellants of the opportunity to establish damage at this time would be inequitable and unjust.

Moreover, it seems eminently unjust that litigants should be so drastically penalized for endeavoring to abide by the stated policy of the District Court directing trial lawyers to try to narrow issues and simplify ligation.

For the foregoing reasons, this petition for rehearing should be granted.

Dated: June 10, 1986

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Robert L. Beck
of Counsel

EXHIBIT

EXHIBIT A

AFFIDAVIT

STATE OF NEW YORK)
COUNTY OF CHAUTAUQUA) S

LOUIS J. NALBONE, being duly sworn, deposes and says:

1. Deponent states that he is a resident of the Town of Pomfret, County of Chautauqua, State of New York and is the President of J & L Oil and Gas Corporation and has been retained by Attorney Robert L. Beck to testify as an expert witness in the matter of Cumberland Gas and Oil vs. James Thropp, et al pending before the U.S. Court of Appeals 2nd Circuit.

2. At Attorney Beck's request this affidavit is prepared to illustrate the type of expert testimony I am prepared to give should this matter go to trial.

3. Deponent states that he is familiar with the wells involved in this pending case. The wells being the Levi Shetler #2A, the Mallery #1, and the Langford #1. I have reviewed the plaintiff's data concerning well completion technique, third party services and other miscellaneous reports.

4. Deponent states that from the data available it appears that the Mallery and the Langford wells at the time of the cementing of the 4-1/2" casing the plug was chased with 15% HCL acid and that as a result of bumping the plug with acid in this manner the acid was allowed to come in contact with the casing and began to eat away at the casing.

5. Deponent further states that from looking at the record it appears as though these wells were stimulated twenty-five (25) days or more from the date of the casing cement job.

6. It is believed by the deponent, and widely held in the industry, that 15% HCL held within 4-1/2" casing with the conditions that were present for the wells described herein would totally eat

through the casing and thereby compromise the completion and end result of these wells in a period of five to ten days.

7. The deponent further states that the industry standard, as well as widely held practice, for installing the acid in the pipe is to first bump the plug down the casing at the time of cementing with fresh water and then 72 hours after this procedure has been completed bring in a service rig and remove the fresh water by the swabbing method. At this point the well stimulation service company would come to the well and place fresh acid down the casing followed by inhibitor and other chemicals as specified by the contractor.

8. The deponent states that by not following the recommended procedure as stated in item 7 and substituting the procedure as described in item 4 and 5 that the contractor saved approximately Three Thousand Dollars ($3,000).

Louis J. Nalbone

Louis J. Nalbone, President
J & L OIL AND GAS CORPORATION

Subscribed and sworn to before
me this 6th day of June, 1986.

Linda J. Jones

Notary Public

LINDA J. JONES #4742937
Notary Public — State of New York
Qualified in Chautauqua County
My Commission Expires Mar. 30, 1987

Supreme Court, U.S.
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No. 86-502

In The

Supreme Court of the United States

OCTOBER TERM, 1986

CUMBERLAND OIL CORPORATION AND SUGAR GROVE, LTD.,

Petitioners,

vs.

JAMES THROPP, GREGORY THROPP, ARROWHEAD GAS PRODUCERS, INC., AND SOUTHERN TIER, INC.,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court of Appeals
For The Second Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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TABLE OF CONTENTS[1]

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF THE CASE	1
A. *The Benchmark/Cumberland agreement*	1
B. *The proceedings below*	2
REASONS WHY THE PETITION SHOULD BE DENIED	4
A. *The Second Circuit correctly decided the issues raised in this case*	4
B. *The decision of the Second Circuit does not demonstrate any conflict in the interpretation of federal law*	6
C. *The decision of the Second Circuit turned on an application of New York substantive law*	7
CONCLUSION	8

[1] Pursuant to Rule 28.1 of the Rules of the Supreme Court of the United States, respondents hereby state that Arrowhead Gas Producers, Inc. is a wholly owned subsidiary of Southern Tier Gas Producers Ltd. (incorrectly named as Southern Tier, Inc.). There are no other subsidiaries or affiliates of either corporation.

TABLE OF AUTHORITIES

	Page
Butner v. United States, 440 U.S. 48 (1979)	7, 8
Cumberland Oil Corp. v. Thropp, 791 F.2d 1037 (2d Cir. 1986)	1, 4
Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938)	7
Mitchell Excavators, Inc. v. Mitchell, 734 F.2d 129 (2d Cir. 1984)	3, 4, 6
United States v. Johnston, 268 U.S. 220, 227 (1925)	6
28 U.S.C. §1332	2
RULES OF SUP. CT. 17.1	6

STATEMENT OF THE CASE

The court below, the United States Court of Appeals for the Second Circuit, affirmed a grant of summary judgment dismissing petitioners' complaint. *Cumberland Oil Corp. v. Thropp,* 791 F.2d 1037 (2d Cir. 1986). Petitioners seek review of the Second Circuit's decision by writ of certiorari. This brief is submitted on behalf of all named respondents in opposition to the petition for writ of certiorari.

A. *The Benchmark/Cumberland agreement.*

In March of 1980 petitioner Cumberland Oil Corporation (hereinafter referred to as "Cumberland") entered into a series of contracts with Benchmark Oil, Inc. (hereinafter referred to as "Benchmark") in connection with a planned gas drilling and development program. The investors in the program were collectively represented by petitioner Sugargrove Ltd., a Georgia limited partnership. Chief among the agreements between Benchmark and Cumberland was a drilling and development agreement, whereby Benchmark agreed to drill three gas wells for Cumberland for a fixed or turnkey price. The drilling agreement was executed by the corporate parties on March 22, 1980. None of the respondents was a party to the contract.

Thereafter, Benchmark drilled three gas wells for petitioner Cumberland. When problems developed with one of the wells, Benchmark redrilled it at no additional cost to Cumberland. Thus, in effect, Benchmark drilled four gas wells and received the agreed price for three.

In addition, as required by the parties' contract, Benchmark completed and hooked up Cumberland's gas wells. The parties agree that all three wells produced gas. However, Cumberland contends that only one of the three wells produces gas in an amount which justifies commercial sale.

During the summer of 1980, both before and after it drilled Cumberland's wells, Benchmark was engaged in the drilling and completion of numerous other gas wells. Between March and October of 1980, Benchmark drilled 22 separate gas wells. However, the company suffered certain financial reverses, and in October of 1980, an involuntary petition in bankruptcy was filed against Benchmark. Ultimately, Benchmark was liquidated in Bankruptcy Court, and it is now a defunct corporation.

Although it had notice of Benchmark's bankruptcy proceedings from their inception in October of 1980, Cumberland took no action against Benchmark in Bankruptcy Court. At no time did it file a proof of claim in Bankruptcy Court. Nor did it commence any adversary proceedings against Benchmark. Rather, throughout the entire period of the Benchmark bankruptcy, Cumberland brought no legal proceedings against Benchmark.

B. *The proceedings below.*

In May of 1983, after the Benchmark bankruptcy proceedings were concluded, Cumberland commenced the instant action in United States District Court for the Western District of New York. Jurisdiction was based on diversity of citizenship. 28 U.S.C. §1332. Cumberland did not name Benchmark as a party defendant. Instead, it named the four respondents in this proceeding: Gregory Thropp, who was President and sole shareholder of Benchmark; James Thropp, who was Gregory's father and alleged to have been a "de facto" principal of Benchmark; Arrowhead Gas Producers, Inc., a corporation owned by the Thropps which purchased Benchmark's assets in Bankruptcy Court; and Southern Tier, Inc. (correctly identified as Southern Tier Gas Producers Ltd.), Arrowhead's parent corporation.

Petitioners' original complaint set forth claims for fraud, breach of contract, and negligence in the drilling of Cumberland's wells. By memorandum-decision and order dated October 5, 1983, the Honorable Michael A. Telesca, United States

District Judge for the Western District of New York, dismissed petitioners' claims for breach of contract and negligence. The court ruled that such claims could have been brought only against Benchmark. Furthermore, the District Court dismissed petitioner's fraud claim against all defendants other than Gregory Thropp.

Thereafter, petitioners filed two amended complaints. The District Court ultimately ruled that their second amended complaint pleaded a claim for fraudulent misrepresentation under New York law, not only against Gregory Thropp, but against the remaining respondents as aiders and abettors. The court specifically noted that, while petitioners had pleaded such a claim, it made no finding that they had proven any such claims.

Considerable discovery was conducted in the case. Finally, pursuant to the District Court's scheduling order, discovery was concluded and cross-motions for summary judgment were filed. Respondents moved for summary judgment dismissing petitioners' complaint on two grounds: first, respondents argued that petitioners' failure to file a claim in the Benchmark bankruptcy proceeding precluded them from maintaining the instant action; secondly, respondents argued that, as a matter of New York law, petitioners could not prove a claim for fraud.

In a decision and order dated August 29, 1985, the Honorable Michael A. Telesca granted respondents' motion for summary judgment dismissing petitioners' complaint. In short, the District Court ruled that under *Mitchell Excavators. Inc. v. Mitchell,* 734 F.2d 129 (2d Cir. 1984), the respondents' claim for fraud was, in essence, an asset of the Benchmark bankruptcy estate. As such, the claim belonged to the trustee in bankruptcy, but not to individual creditors such as the petitioners. Therefore, the District Court ruled that their claims should have been presented first to the Bankruptcy Court.

Petitioners appealed to the United States Court of Appeals for the Second Circuit. Petitioners argued that *Mitchell Excavators,*

supra, was inapplicable to the instant case. Respondents argued that the District Court had correctly applied *Mitchell Excavators* to the facts below. In addition, respondents renewed their alternative argument which had been raised in District Court — namely, that petitioners had no claim for fraud under New York Law.

In an opinion dated May 30, 1986, the United States Court of Appeals for the Second Circuit affirmed the grant of summary judgment dismissing petitioners' complaint. *Cumberland Oil Corp. v. Thropp,* 791 F.2d 1037 (2nd Cir. 1986) (a copy of the opinion of the Court of Appeals is reproduced as Appendix B, annexed to the petition for a writ of certiorari). The Court of Appeals held that *Mitchell Excavators. Inc. v. Mitchell, supra,* did not bar the instant action. However, the court went on to hold that, under New York law, respondents were entitled to summary judgment dismissing petitioners' complaint. The court held that petitioners had failed to establish at least one of the elements of a claim for fraud under New York law, specifically, proximate cause. *Id.;* Appendix B-17. Furthermore, the Court of Appeals noted that there was some question as to whether Gregory Thropp's alleged misrepresentations were statements of fact which would give rise to a claim for fraud. *Id.;* Appendix B-16.

Accordingly, on the basis of New York law which governs this diversity action, the Court of Appeals affirmed the grant of summary judgment dismissing petitioners' complaint as a matter of law. Petitioners sought a rehearing, but their application was denied. Appendix C. This petition for a writ of certiorari followed.

REASONS WHY THE PETITION SHOULD BE DENIED

A. *The Second Circuit correctly decided the issues raised in this case.*

The Court of Appeals for the Second Circuit ruled that petitioners had no claim for fraud under New York law, as they had

no proof of proximate cause. Petitioners allege that they were fraudulently induced to enter into the drilling and development contract with Benchmark. Nevertheless, the record shows that petitioner Cumberland received exactly what it contracted for — three gas wells. Benchmark drilled, completed, and hooked up three wells for Cumberland as agreed. Moreover, when one well developed problems, Benchmark redrilled it at no extra cost.

The parties were in dispute as to the results of Benchmark's efforts. Petitioners contend that only one well produced gas in commercially salable quantities. Respondents contend, however, that all three wells would produce gas if properly tended. The fact remains that Benchmark completed petitioners' wells as promised. The drilling and development agreement contained no warranties or representations regarding the level of gas production.

In addition, the record demonstrated, without contradiction, that Benchmark was actively engaged in the drilling of gas wells throughout the spring and summer of 1980. In all, Benchmark drilled 22 wells. When drilling and completing petitioners' wells, Benchmark utilized its full regular field crew — close to 25 employees. Also, as stated, Benchmark drilled a fourth well for petitioners at no extra cost.

Thus, any of petitioners' alleged damages resulted from the inherent uncertainties of natural gas production. Petitioners' alleged damages were entirely unrelated to the conduct of any of the respondents in connection with the negotiations for, or execution of, the Benchmark/Cumberland drilling and development agreement. Although petitioners contend that the Thropps misrepresented that Benchmark was ready, willing and able to perform the drilling agreement, the record demonstrates exactly the opposite. Benchmark was not only ready, willing and able to perform, it did perform beyond the requirements of the agreement.

The questions presented by petitioners suggest that the Court of Appeals improperly affirmed the grant of summary judgment

in the face of issues of fact. Petitioners further suggest that the court below improperly concluded that no proof of damages could be established. These questions are insufficient to warrant the exercise of certiorari by this court. In the first place, as indicated above, the Second Circuit correctly decided the case. Secondly, petitioners are really arguing that the court below decided this case incorrectly. This court has stated that it does, "not grant a certiorari to review evidence and discuss specific facts." *United States v. Johnston,* 268 U.S. 220, 227 (1925). Accordingly, the petition for a writ of certiorari should be denied.

B. *The decision of the Second Circuit does not demonstrate any conflict in the interpretation of federal law.*

Rule 17.1 of the Rules of This Court states that review by writ of certiorari may be appropriate when a federal Court of Appeals has rendered a decision which creates a significant conflict in the interpretation of federal law. RULES OF SUP. CT. 17.1. This consideration is entirely absent from the instant case.

The sole federal issue reached by the Court of Appeals for the Second Circuit was the application of *Mitchell Excavators. Inc. v. Mitchell,* 734 F.2d 129 (2d Cir. 1984), to the facts of this case. Specifically, the Second Circuit ruled that its holding in *Mitchell Excavators, supra,* did not require that petitioners' claim first be presented to the Bankruptcy Court. The court ruled that the fraud cause of action belonged to petitioner Cumberland, and not to Benchmark or the trustee in bankruptcy. Appendix B-12. Thus, petitioners could maintain this action despite their failure to proceed against Benchmark in Bankruptcy Court.

In the first place, this ruling was favorable to the petitioners and is not challenged by any party to these proceedings. In the second place, this ruling did not conflict with any ruling of any other Court of Appeals. Rather, the Second Circuit merely determined that its prior holding was not applicable to the facts of this case.

Thus, as this case involves no conflict regarding federal law, and as none of the considerations set forth in Rule 17.1 are present, the petition for a writ of certiorari should be denied.

C. *The decision of the Second Circuit turned on an application of New York substantive law.*

This is a diversity action. Accordingly, the substantive law of New York applies under *Erie Railroad Co. v. Tompkins,* 304 U.S. 64 (1938). Therefore, in ruling that petitioners could not sustain a claim for fraudulent misrepresentation, the Second Circuit applied New York law to the facts of this case.

First, the Second Circuit set forth the essential elements of a claim for fraud in New York. *See* Appendix B-16. Next, the court reviewed the facts of this case in light of these essential elements. Specifically, the Second Circuit ruled that petitioners had failed to demonstrate the essential element of proximate cause. Appendix B-17. Furthermore, the court noted, in dictum, that respondents' alleged misrepresentations were not necessarily statements of fact which are required to sustain a claim for fraud. Appendix B-16.

The courts of the State of New York are the final authorities for determining the substantive issues of law raised in this action. In diversity cases, however, the Court of Appeals for the Second Circuit is often called upon to interpret and apply New York law to diversity cases pending in the federal courts within the Second Circuit. This Court has recognized that, under these circumstances, the appropriate tribunal in the federal system for resolving issues of state law is the Second Circuit Court of Appeals, and not the United States Supreme Court. "The federal judges who deal regularly with questions of state law in their respective districts and circuits are in a better position. . .to determine how local courts would dispose of comparable issues." *Butner v. United*

States, 440 U.S. 48, 58 (1979). As the decision below turned on the application of New York State law, the petition for a writ of certiorari should be denied.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

Dated: October 16, 1986

Respectfully submitted,

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No. 86-502

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OCTOBER TERM, 1986

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Respondents.

On Petition For A Writ of Certiorari
To The United States Court of Appeals
For The Second Circuit

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TABLE OF CONTENTS

	Page
ARGUMENT	1
CONCLUSION	3

In The

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OCTOBER TERM, 1986

CUMBERLAND OIL CORPORATION AND SUGARGROVE, LTD.,

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Respondents.

ARGUMENT

PETITIONERS WERE DENIED DUE PROCESS OF LAW BY NOT BEING PERMITTED TO PROFFER THE EXTENSIVE PROOF WHICH EXISTS TO ESTABLISH PROXIMATE CAUSE AND DAMAGES.

Respondents argue that the Court of Appeals for the Second Circuit ruled that petitioners had no claim for fraud under New York law, as they had no proof of proximate cause.

This is not correct.

It is the very heart of petitioners' argument that the Court of Appeals, by affirming summary judgment, actually ruled that even if given the opportunity to present proof petitioners could

not possibly prove damages or proximate cause. (Appendix B-19) The difference is of the utmost constitutional importance. The Court of Appeals simply based its ruling on sheer inference, ignoring, *in toto* (as did the District Court) petitioners' formal request for bifurcation of the issues of liability and damages. (Appendix D-3)

As stated, petitioners made no attempt to establish proximate cause at the pre-trial level, but offered to do so once the other issues of liability were resolved. This was done to accommodate the District Court's oft-stated request of trial lawyers to simplify trial issues, protect the Court's time, proceed in an orderly fashion and avoid unnecessary expense.

As will appear in the Petition for Reargument, petitioners stand ready to offer solid proof to establish those damages which the Court of Appeals has *inferred* do not exist.

The issue before this Court, therefore, is simply whether or not petitioners have been denied due process of law by not having been permitted to proffer the extensive proof which exists to establish proximate cause and very great damage.

In short, does *any* Court by the arbitrary use of inference have the power to so summarily destroy the rights of litigants?

CONCLUSION

FOR THE FOREGOING REASONS, AS WELL AS THOSE WHICH HAVE BEEN URGED IN THE PETITION, CERTIORARI SHOULD BE GRANTED.

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